



**U.S. Department of the Interior
Office of Inspector General**

**INDEPENDENT AUDITORS' REPORT
ON THE TRIBAL AND OTHER TRUST FUNDS
AND INDIVIDUAL INDIAN MONIES TRUST FUNDS
FINANCIAL STATEMENTS FOR
FISCAL YEARS 2006 AND 2005
MANAGED BY THE
OFFICE OF THE SPECIAL TRUSTEE
FOR AMERICAN INDIANS**



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, DC 20240

Memorandum

DEC 14 2006

To: Special Trustee for American Indians

From: Anne L. Richards *Anne L. Richards*
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Tribal and Other Trust Funds and Individual Indian Monies Trust Funds Financial Statements for FY2006 and FY2005 (Report No. Q-IN-OST-0001-2006)

INTRODUCTION

This memorandum transmits KPMG LLP's (KPMG) auditors' report of the Office of the Special Trustee for American Indians (OST) financial statements for FY2006 and FY2005. The OST financial report contains separate financial statements and notes for Tribal and Other Trust Funds and Individual Indian Monies (IIM) trust funds.

The American Indian Trust Fund Management Reform Act of 1994 requires an audit of the Tribal and IIM financial statements. Under a contract issued by OST and monitored by the Office of Inspector General (OIG), KPMG, an independent public accounting firm, performed an audit of the OST FY2006 and FY2005 financial statements. The contract required that the audit be performed in accordance with auditing standards generally accepted in the United States of America and the "Government Auditing Standards" issued by the Comptroller General of the United States.

RESULTS OF INDEPENDENT AUDIT

In its audit report, dated November 9, 2006, KPMG issued qualified opinions on the Trust Funds financial statements because certain parties for whom OST holds assets in trust:

- have filed a class action lawsuit for an accounting of the individuals' trust funds, which may or may not lead to claims against the United States Government;
- do not agree with the balances recorded by OST and/or have requested an accounting of their trust funds; or
- have filed or are expected to file claims against the United States Government.

In addition, inadequacies in certain Department of the Interior trust-related systems and processes made it impracticable to extend auditing procedures sufficiently to satisfy auditors as

to the fairness of trust fund balances. KPMG identified one reportable condition related to internal controls over financial reporting: reliance on processing of trust transactions at the Bureau of Indian Affairs and unresolved financial reporting matters from prior periods. KPMG considers the reportable condition to be a material weakness. KPMG found no instances where OST did not comply with laws and regulations.

EVALUATION OF KPMG AUDIT PERFORMANCE

To fulfill our monitoring responsibilities, the OIG:

- reviewed KPMG's approach and planning of the audit;
- evaluated the qualifications and independence of the auditors;
- monitored the progress of the audit at key points;
- coordinated periodic meetings with DOI management to discuss audit progress, findings, and recommendations;
- reviewed and accepted KPMG's audit report; and
- performed other procedures we deemed necessary

KPMG is responsible for the attached auditors' report, dated November 9, 2006, and the conclusions expressed. We do not express an opinion on OST financial statements, internal controls, or compliance with laws and regulations.

REPORT DISTRIBUTION

The legislation, as amended, creating the Office of Inspector General (5 U.S.C.A. app. 3) requires semiannual reporting to Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, this report will be included in our next semiannual report. The distribution of the report is not restricted and copies are available for public inspection.

The OIG appreciates the courtesies and cooperation extended to KPMG and our staff during the audit. If you have any questions regarding the report, please contact me at 202-208-5512.

Attachment

cc: Principal Deputy Special Trustee
Director, Office of Trust Review and Audit, Office of Special Trustee
Program Analysis Officer, Office of Special Trustee
Director, Office of Financial Management
Associate Director, Finance, Policy and Operations, Office of Financial Management
Audit Liaison Officer, Office of Financial Management
Focus Group Leader, Management Control and Audit Followup, Office of Financial Management

**TRIBAL AND OTHER TRUST FUNDS AND
INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**



ANNUAL REPORT 2006

**TRIBAL AND OTHER TRUST FUNDS AND
INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

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Letter from the Special Trustee

I am pleased to present the Office of the Special Trustee for American Indians' (OST) fiscal year 2006 audited financial statements. This letter provides information about what our office has accomplished to help the Department of the Interior fulfill its fiduciary responsibilities to American Indians, Alaska Natives, and tribes.

At OST, our day-to-day work is guided by our Indian trust management mission statement – to perform our fiduciary trust responsibilities to American Indian tribes, individual Indians, and Alaska Natives by incorporating a beneficiary focus and beneficiary participation while providing effective, competent, stewardship and management of trust assets.

Interior's Comprehensive Trust Management Plan (CTM) guides and describes the vision, goals, and objectives of fiduciary trust management and operations of the trust for all bureaus and offices within Interior. Achieving the goals in the plan will result in enhanced beneficiary services, reliable ownership information, and quality administrative services; improved management of all trust fund assets and increased support for Indian self-governance and self-determination.

OST supports its goal to fulfill Indian fiduciary trust responsibilities by implementing the following strategies:

Improve Indian Fiduciary Trust Beneficiary Services by continuing our efforts to provide timely, accurate account performance statements and convenient access to trust account services; communicating with beneficiaries and facilitating beneficiary involvement in trust management.

Support Indian Self-Governance and Self-Determination by fostering expansion of self-governance compacts and self-determination contracts.

Improve Indian Trust Ownership and Other Information through prompt distribution of financial trust assets to heirs after the Office of Hearing and Appeals (OHA) renders probate decisions; and ensuring accuracy of data maintained in offices and accounting systems.

Manage Trust Fund Assets for Timely and Productive Use through managing and investing funds held on behalf of individual Indians and

tribes; and, collecting, disbursing, and accounting for funds timely and accurately.

Improve Management of Land and Natural Resource Assets by obtaining appraisal information as needed on trust and restricted lands for tribal and individual Indian owners; and supporting the Indian Land Consolidation program to reduce the number of fractionated ownership interests in land.

Below are some of OST's 2006 accomplishments that will help improve services to trust beneficiaries:

- Expanded Trust Beneficiary Call Center hours to 8 am to noon on Saturday mornings so beneficiaries would have more access to staff for their trust questions.
- Provided information to beneficiaries on their accounts and services available to them through OST by producing and distributing booklets, brochures and statement inserts.
- Converted four regions and a number of additional agency offices to reformed accounting, title, and data management systems, and business procedures. The new systems enable employees to track leasing activity, ownership and income distribution electronically to ensure more efficiency and accountability. These conversions account for 81% of recurring Individual Indians Monies (IIM) income and 73 percent of IIM accounts.
- Delivered quarterly performance statements that provide information to beneficiaries that own assets in the converted regions regarding source of funds, encumbrance information (who is leasing their trust property, duration of the lease and payment terms), and a listing of the trust property they own. This information supports compliance with the American Indian Trust Fund Management Reform Act of 1994.
- Recorded 99.8% of the revenue received from Minerals Management Service in the Trust Funds Accounting System within 24 hours of receipt.
- Completed implementation of a centralized commercial lockbox process that was initiated in FY 2005. Funds received through the lockbox will be deposited within one business day. Completed phase II for 81% of recurring IIM income, the implementation of these systems provides the funds receivable capabilities that have been identified as a weakness in previous audits.

- Met the goal of distributing trust assets through probate in a 10-day timeframe.
- Maintained self-governance and self-determination agreements with 38 tribes for the estate appraisals and beneficiary trust functions, and began negotiations with three more tribes to self-manage these programs.
- The Office of Appraisal Services (OAS), in partnership with the Appraisal Services Directorate, developed a department-wide appraisal handbook, established an Office of Minerals Evaluation and completed the development of the Indian Trust Appraisal Request Tracking System.
- Partnered with BIA and BLM to place a BLM surveyor at each of the 12 BIA regional offices, and collaborated to develop a certification program where state licensed land surveyors can be certified to perform commercial activities under the direction and control of BLM.
- Collaborated with BIA, the State of New Mexico and the U.S. Army Corps of Engineers to produce digital orthoimages of the Navajo Nation, Hopi Nation and the Jicarilla reservation to assist in the preservation, promotion and protection of the trust resources.
- Awarded the Cannon Financial Institute *Certified Indian Fiduciary Trust Specialist* designation to thirty OST employees.
- Collected 24,370 cubic feet of records, and indexed 23,315 cubic feet of records. Once these records are indexed they will be stored, maintained and preserved at the American Indian Records Repository.
- Provided records management training to more than 500 BIA and OST records contacts and 381 tribal employees.
- Reviewed 34% of BIA and OST offices to identify improvements needed in their Records Management Program.
- Helped fund and support programs at the new National Indian Programs Training Center, based in Albuquerque, NM.
- Co-hosted with BIA a department-wide "State of Indian Affairs" address to provide employees a status report on their efforts and the goals of Indian Affairs programs.

We continue to face the incredible challenge of continued court-ordered disconnection from the Internet. In spite of such technological challenges, OST has improved its ability to serve its trust beneficiaries. In keeping with the CTM, OST will pursue the following during Fiscal Year 2007:

- Continue to work with BIA to convert the remaining BIA agencies from multiple legacy software systems to the Trust Asset and Accounting System (TAAMS) leasing module interfacing to the Trust Funds Accounting System (TFAS) by the end of 2007.
- Complete the phase II of the lockbox / funds receivable system to allow for the generation of automatic invoices to lessees and expedite payment to beneficiaries.
- Continue to address the backlog of probates, as well as an ongoing regulatory update initiative to improve and streamline probate processes.
- Continue to address the backlog of appraisal requests on trust land, and improve the tracking of appraisal status.
- Incorporate new Royalty Distribution and Reporting System (RDRS) module to facilitate the provision of improved oil and gas payment information to beneficiaries.
- Extend access to reformed DOI information systems, and training opportunities, to tribes to build their capacity for operating trust programs under PL 98-638 agreements.
- Expand training opportunities for Indian Affairs employees and tribes to provide effective program management.
- Support Interior's efforts to improve land management for tribes and individuals including the use of advanced technologies.

I hope you find this year's Annual Report informative and useful. We welcome your help, comments, or suggestions for continued improvement.



Ross O. Swimmer
Special Trustee for American Indians



**TRIBAL AND OTHER TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Financial Statements

September 30, 2006 and 2005

(With Independent Auditors' Report on Financial Statements Thereon)



KPMG LLP
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PO Box 3990
Albuquerque, NM 87190

Independent Auditors' Report on Financial Statements

The Special Trustee for American Indians
U.S. Department of the Interior Office of the Special Trustee for American Indians:

We have audited the accompanying statements of assets and trust fund balances – cash basis of the Tribal and Other Trust Funds managed by the U.S. Department of the Interior Office of the Special Trustee for American Indians (OST) as of September 30, 2006 and 2005, and the related statements of changes in trust fund balances – cash basis for the years then ended. These financial statements are the responsibility of management of OST. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the fourth paragraph of this report, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control over financial reporting of the Tribal and Other Trust Funds managed by OST. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in note 2, these financial statements were prepared on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

It was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the fairness of trust fund balances in the accompanying financial statements as of September 30, 2006 and 2005 due to certain parties for whom OST holds assets in trust disagreeing with balances recorded by OST and/or having requested an accounting of their trust funds, and certain of these parties have filed, or are expected to file, claims against the United States Government and due to inadequacies in certain Department of the Interior trust-related systems and processes, which provide required trust financial information to OST. Trust fund balances enter into the determination of financial position and changes in trust fund balances.

In our opinion, except for the effects on the financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to apply adequate procedures to determine the fairness of trust fund balances and related changes in trust fund balances, as discussed in the preceding paragraph, the financial statements referred to in the first paragraph above present fairly, in all material respects, the financial position of the Tribal and Other Trust Funds managed by OST as of September 30, 2006 and 2005, and the changes in trust fund balances for the years then ended in conformity with the basis of accounting described in note 2.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 9, 2006, on our consideration of internal control over financial reporting and on our tests of Tribal and Other Trust Funds compliance with certain provisions of laws, regulations, contracts and other matters of the Tribal and Other Trust Funds managed by OST. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

KPMG LLP

November 9, 2006

**TRIBAL AND OTHER TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Statements of Assets and Trust Fund Balances – Cash Basis

September 30, 2006 and 2005

(In thousands)

| Assets | 2006 | 2005 |
|---|---------------------|------------------|
| Cash and cash equivalents (note 3) | \$ 503,399 | 501,596 |
| Investments (note 4) | <u>2,417,827</u> | <u>2,380,222</u> |
| Total assets | <u>\$ 2,921,226</u> | <u>2,881,818</u> |
| Trust Fund Balances | | |
| Held for Indian tribes (notes 6 and 8) | \$ 2,637,066 | 2,604,516 |
| Held by the Department of the Interior and considered to be U.S. Government funds (note 6) | <u>284,160</u> | <u>277,302</u> |
| Total trust fund balances | <u>\$ 2,921,226</u> | <u>2,881,818</u> |

See accompanying notes to financial statements.

**TRIBAL AND OTHER TRUST FUNDS
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Statements of Changes in Trust Fund Balances – Cash Basis

Years ended September 30, 2006 and 2005

(In thousands)

| | 2006 | 2005 |
|---|--------------|-------------|
| Increases: | | |
| Receipts | \$ 338,896 | 352,921 |
| Interest received on invested funds | 121,566 | 146,330 |
| Gain on disposition of investments, net | 24 | 18,487 |
| | 460,486 | 517,738 |
| Decreases: | | |
| Disbursements to and on behalf of Indian tribes and other trust funds and withdrawal of trust funds by Indian tribes (note 8) | (421,078) | (611,152) |
| Increase (decrease) in trust fund balances, net | 39,408 | (93,414) |
| Trust fund balances, beginning of year | 2,881,818 | 2,975,232 |
| Trust fund balances, end of year (notes 6 and 8) | \$ 2,921,226 | 2,881,818 |

See accompanying notes to financial statements.

**TRIBAL AND OTHER TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
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Notes to Financial Statements

September 30, 2006 and 2005

(1) Background and Description of the Trust Funds

(a) Overview of the Trust Funds

Establishment and Management of the Trust Funds – The legislation that authorizes the Secretary of the United States Department of the Interior (Secretary) to manage the Tribal and Other Trust Funds (Trust Funds) recognizes the unique trust relationship that exists between the Indian tribes, individual Indians, and the United States Government (U.S. Government). Agreements between the U.S. Government and the various Indian tribes, many of these in the form of treaties, recognize the sovereignty of tribes. During the course of the Nation's history and the U.S. Government's evolving policies toward Indian tribes, the trust relationship has retained characteristics based upon tribal sovereignty. The United States Congress has designated the Secretary as the trustee delegate with responsibility for the financial and non-financial resources held in trust on behalf of American Indian tribes, individual Indians, and other trust funds. In carrying out the management and oversight of the Indian trust assets, the Secretary has a fiduciary responsibility to ensure monies are received for the use of Indian lands and the extraction of natural resources from Indian lands, distribute such monies collected to the appropriate beneficiaries, ensure that trust accounts are properly maintained and invested, and ensure that accurate and complete reports are provided to the trust beneficiaries in accordance with applicable law.

The balances that have accumulated in the Trust Funds have resulted generally from judgment awards, settlement of claims, land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources, and investment income.

The accompanying financial statements include only the financial assets held in trust by the Office of the Special Trustee for American Indians (OST) for trust beneficiaries and do not include: (i) the operating account balances of OST (e.g., Fund Balance with Treasury, Property, Plant, and Equipment) or (ii) other Indian trust assets, including but not limited to, Indian lands, buildings, or other non-financial assets managed by the United States Department of the Interior (Department).

The Reform Act – The American Indian Trust Fund Management Reform Act of 1994 (Public Law 103-412) (the Reform Act) authorized the establishment of OST which is headed by the Special Trustee for American Indians (Special Trustee) who reports to the Secretary. Under this legislation, the Special Trustee is responsible for oversight, reform, and coordination of the policies, procedures, systems, and practices used by various bureaus and offices of the Department, including but not limited to OST, the Bureau of Indian Affairs (BIA), the Minerals Management Service (MMS), and the Bureau of Land Management (BLM), in managing Indian trust assets.

Office of the Special Trustee for American Indians – Indian trust assets, including the Trust Funds, are primarily managed under the delegated authority of OST and BIA. Management of Indian trust assets on behalf of the trust beneficiaries is dependent upon the processing of trust-related transactions within certain information systems of the Department, including but not limited to OST, BIA, MMS, and other Departmental bureaus and offices. BIA and other Departmental bureaus and offices are responsible for managing the natural resources located within the boundaries of Indian

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Notes to Financial Statements

September 30, 2006 and 2005

reservations and trust lands, as well as the processing of data regarding the ownership and leasing of Indian lands. The allocation and distribution of receipts and disbursements by OST to trust beneficiaries is significantly dependent and reliant upon the receipt of timely and accurate information derived from records maintained by BIA, MMS, and other Departmental bureaus and offices (see note 7).

Regional Offices – OST and BIA maintain staff at regional offices located throughout the United States.

Agency and Field Offices – OST and BIA maintain staff at agency and field offices located throughout the United States, which are generally located near the tribes and individual Indians served. OST and BIA personnel located at most of the agency and field offices perform various functions related to trust fund activities.

(b) Description of the Trust Funds

Certain of the Trust Funds are subject to legal, regulatory, budgetary, court-ordered, or other restrictions (see note 6). A brief description of the Trust Funds follows:

- **Tribal Trust Funds** – Approximately 1,450 accounts comprise the Tribal Trust Funds, which totaled approximately \$2,637,066,000 and \$2,604,516,000 as of September 30, 2006 and 2005, respectively.

Tribal Trust Funds realize receipts from a variety of sources, including judgment awards, settlement of claims, land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources, and investment income.

- **Other Trust Funds** – Other Trust Funds are comprised of those funds classified as *Held by the Department of the Interior and considered to be U.S. Government funds* (see note 6). Other Trust Funds totaled approximately \$284,160,000 and \$277,302,000 as of September 30, 2006 and 2005, respectively.

Other Trust Funds realize receipts from a variety of sources including leases, rights-of-way, settlement of Indian claims, donations and bequests, and investment income.

(c) Investment of Trust Funds

Authorizing legislation and a substantial body of case law specify how Indian trust funds should be managed and which financial instruments constitute appropriate investments for Indian trust funds. The Trust Funds are invested in U.S. Government securities, including U.S. Department of the Treasury (U.S. Treasury) issues, U.S. Government agency issues, and U.S. Government-sponsored entity issues.

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September 30, 2006 and 2005

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

OST uses the cash basis of accounting for the Trust Funds, which is a comprehensive basis of accounting other than generally accepted accounting principles. The cash basis of accounting differs from generally accepted accounting principles in that receivables and payables are not accrued and premiums and discounts on investments are not amortized or accreted. Receipts are recorded when received and disbursements are recorded when issued. Investments are stated at historical cost. Interest received on invested funds reported in the statements of changes in trust fund balances reflects interest received during the fiscal year.

(b) Cash and Cash Equivalents

Management considers all highly liquid financial instruments with maturities of three months or less when purchased to be cash equivalents.

(c) Investments

Investment securities at September 30, 2006 and 2005 consist of U.S. Treasury issues, U.S. Government agency issues, and U.S. Government-sponsored entity issues. Investment securities are recorded at historical cost. Interest income is recognized when received.

The Trust Funds' investments have a concentration in U.S. Government securities, as mandated by 25 USC 162.

(d) Receipts

Receipts from various leasing activities, mineral royalties and sales of extracted minerals, timber and other forest products, fees and fines, and the granting of easements are generated from a variety of non-financial assets that are held in trust by the U.S. Government and managed by BIA and other Departmental bureaus and offices on behalf of tribes. Receipts on hand at the regional and agency offices, and/or in-transit at September 30, 2006 and 2005, if any, awaiting deposit to the U.S. Treasury, are not included in the accompanying financial statements.

Receipts also include payments from the U.S. Government for judgment awards and the settlement of claims.

(e) Disbursements

Payments disbursed from the Trust Funds consist of accumulations of funds from various income-producing activities such as leasing, royalty receipts, minerals extraction, timber and other forest product sales, judgment awards, settlement of claims, and investment income. Under certain conditions, tribes disburse per capita payments to their enrolled members.

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Public Law 103-412 specifically allows for the voluntary withdrawal of judgment awards and settlement of claims funds from the Trust Funds. Except where prohibited by statute, an Indian tribe may submit a plan to withdraw some or all funds held in trust for the tribe in accordance with 25 CFR 1200.

(f) Use of Estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets at the date of the financial statements and the reported amounts of increases and decreases in trust fund balances during the reporting period. Actual results could differ from those estimates.

(3) Cash and Cash Equivalents

Cash equivalents of approximately \$503 million and \$499 million at September 30, 2006 and 2005, respectively, consist of overnight investments with the U.S. Treasury.

(4) Investments

The historical cost, gross unrealized holding gains, gross unrealized holding losses, and fair value of investment securities by major class of security at September 30 were as follows (amounts exclude investments in U.S. Treasury overnight securities discussed in note 3):

| | <u>Historical cost</u> | <u>Gross unrealized holding gains</u> | <u>Gross unrealized holding losses</u> | <u>Fair value</u> |
|-------------------------------------|----------------------------|---|--|-------------------|
| | (in thousands) | | | |
| At September 30, 2006: | | | | |
| U.S. Treasury and agency securities | \$ 2,235,471 | 7,672 | (30,287) | 2,212,856 |
| Mortgage-backed securities | 182,356 | 127 | (3,912) | 178,571 |
| | <u>\$ 2,417,827</u> | <u>7,799</u> | <u>(34,199)</u> | <u>2,391,427</u> |
| At September 30, 2005: | | | | |
| U.S. Treasury and agency securities | \$ 2,205,557 | 11,329 | (29,837) | 2,187,049 |
| Mortgage-backed securities | 174,665 | 387 | (2,288) | 172,764 |
| | <u>\$ 2,380,222</u> | <u>11,716</u> | <u>(32,125)</u> | <u>2,359,813</u> |

Certain of the September 30, 2005 amounts above have been reclassified between security types to conform to the September 30, 2006 classifications.

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September 30, 2006 and 2005

Maturities of investment securities were as follows at September 30, 2006:

| | Historical cost | Fair value |
|--|------------------------|-------------------|
| | (in thousands) | |
| Due in one year or less | \$ 450,283 | 448,528 |
| Due after one year through five years | 873,879 | 860,834 |
| Due after five years through ten years | 504,143 | 500,134 |
| Due after ten years | 589,522 | 581,931 |
| | \$ 2,417,827 | 2,391,427 |

(5) Contingencies

Certain Indian tribes for whom OST holds assets in trust do not agree with balances recorded by OST and/or have requested an accounting of their trust funds, and certain of these Indian tribes have filed, or are expected to file, claims against the U.S. Government for failure to fulfill its fiduciary responsibilities and for other related charges. Thirty-six tribal trust cases currently are pending in various Federal district courts and the U.S. Court of Federal Claims. The cases, which were brought by twenty-nine different tribes, involve claims for trust fund and asset mismanagement, accounting, and other declaratory relief. A substantial number of the cases are stayed pending settlement negotiations or discovery. In addition, in many of these cases, the court does not have jurisdiction to grant monetary relief. Neither OST nor the Office of the Solicitor for the Department can presently determine the outcome of these actions nor the total amount, responsibility, and funding source of the potential liability. Any settlement resulting from an adverse outcome of the contingencies described above is not expected to be satisfied with trust fund balances. No amounts have been recorded in the accompanying Trust Funds' financial statements for potential claims from the U.S. Government.

(6) Trust Fund Balances

Trust fund balances are the aggregation of financial assets held in trust and represent the amounts owed to beneficiaries as of September 30, 2006 and 2005 for which OST has a fiduciary responsibility.

The Trust Funds contain the following Trust Fund balance categories for U.S. Government budget purposes, which are reflected as separate components in the accompanying financial statements:

- *Held for Indian tribes* – These represent funds held on behalf of Indian tribes. These funds are considered non-Federal monies.
- *Held by the Department of the Interior and considered to be U.S. Government funds* – These represent funds, some of which will be transferred to the *Held for Indian tribes* category provided certain conditions are satisfied, and for others, the corpus of the fund may be nonexpendable. These funds are considered U.S. Government monies.

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A portion of trust fund balances represents estimated payments on production-type leases for which certain tribes and individual Indians hold an interest. When certain adjustments to production are identified, estimated payments in excess of production are returned to the depositor or adjusted for in future payments.

(7) Related-Party Transactions with Other Government Organizations

(a) U.S. Department of the Interior Bureau of Indian Affairs

BIA is responsible for the collection of certain monies resulting from the management and use of Indian trust lands and other trust resources. Upon receipt, OST records the deposit of trust funds to trust accounts based on the information received from BIA.

(b) U.S. Department of the Interior Minerals Management Service

For certain trust leases, MMS is responsible for the collection of royalty payments on behalf of Indian tribes and individual Indians holding mineral rights. MMS deposits the royalty payments with the U.S. Treasury and electronically transfers to OST the related accounting information, generally the next business day. The accounting information received from MMS provides OST an allocation of 100% tribally owned lease royalties, enabling OST to record trust deposits directly into tribal accounts. For tribally/individually co-owned leases, and individually owned leases, allocation and accounting data is forwarded to OST via electronic interface through the Royalty Distribution Reporting System that is maintained by BIA. Pursuant to established procedure and appropriate authorization, the data is recorded by OST. MMS and BLM both perform verification and other monitoring procedures of mineral assets. Oil and gas companies sometimes forward payments to MMS based on estimated mineral production in order to comply with the Federal Oil and Gas Royalty Management Act of 1982 that requires timely distribution of royalties. These estimated payments may be disbursed by OST to the beneficiaries. Typically, the oil and gas companies adjust future payments for excess or shortfall amounts, if any, based on actual production.

(c) Other

The U.S. Treasury holds cash and certain investments and in certain instances disburses for OST.

The Department's Office of the Solicitor serves as legal counsel for OST.

(8) Transfers of Trust Funds

OST, pursuant to information provided by BIA, utilizes special deposit accounts maintained within the Individual Indian Monies (IIM) Trust Funds for both tribal and IIM beneficiaries as suspense accounts, whereby funds are temporarily posted when allocation information is not provided when the funds are received. Following receipt of allocation information from BIA, the funds are transferred from the special deposit accounts to the designated tribal and/or IIM account(s). Special deposit accounts totaled approximately \$36 million and \$40 million as of September 30, 2006 and 2005, respectively. The majority of the special deposit account monies held in the IIM Trust Funds relates to historical balances and has not

**TRIBAL AND OTHER TRUST FUNDS
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been distributed because the ultimate disposition of the funds has not been determined. Since the ultimate disposition is unknown at September 30, 2006, the portion attributable to the Tribal and Other Trust Funds is unknown. In addition, certain per capita disbursements authorized by tribes result in transfers from the Tribal and Other Trust Funds to the IIM Trust Funds while certain oil and gas distributions may result in transfers to/from the IIM Trust Funds from/to the Tribal and Other Trust Funds. Net transfers of trust funds from the Tribal and Other Trust Funds to the IIM Trust Funds totaled approximately \$43.3 million and \$34.1 million during the years ended September 30, 2006 and 2005, respectively. These transfers are reflected as disbursements in the accompanying statements of changes in trust fund balances.



**INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Financial Statements

September 30, 2006 and 2005

(With Independent Auditors' Report on Financial Statements Thereon)



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Albuquerque, NM 87190

Independent Auditors' Report on Financial Statements

The Special Trustee for American Indians
U.S. Department of the Interior Office of the Special Trustee for American Indians:

We have audited the accompanying statements of assets and trust fund balances – modified cash basis of the Individual Indian Monies Trust Funds managed by the U.S. Department of the Interior Office of the Special Trustee for American Indians (OST) as of September 30, 2006 and 2005, and the related statements of changes in trust fund balances – modified cash basis for the years then ended. These financial statements are the responsibility of management of OST. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the fourth paragraph of this report, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control over financial reporting of the Individual Indian Monies Trust Funds managed by OST. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in note 2, these financial statements were prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

It was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the fairness of trust fund balances in the accompanying financial statements as of September 30, 2006 and 2005 due to certain parties for whom OST holds assets in trust having filed a class action lawsuit for an accounting of the individuals' trust funds which may or may not lead to claims against the United States Government and due to inadequacies in certain Department of the Interior trust-related systems and processes, which provide required trust financial information to OST. Trust fund balances enter into the determination of financial position and changes in trust fund balances.

In our opinion, except for the effects on the financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to apply adequate procedures to determine the fairness of trust fund balances and related changes in trust fund balances, as discussed in the preceding paragraph, the financial statements referred to in the first paragraph above present fairly, in all material respects, the financial position of the Individual Indian Monies Trust Funds managed by OST as of September 30, 2006 and 2005, and the changes in trust fund balances for the years then ended in conformity with the basis of accounting described in note 2.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 9, 2006, on our consideration of internal control over financial reporting and on our tests of Individual Indian Monies Trust Funds compliance with certain provisions of laws, regulations, contracts, and other matters of the Individual Indian Monies Trust Funds managed by OST. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

KPMG LLP

November 9, 2006

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Statements of Assets and Trust Fund Balances -- Modified Cash Basis

September 30, 2006 and 2005

(In thousands)

| Assets | <u>2006</u> | <u>2005</u> |
|---|--------------------|--------------------|
| Cash and cash equivalents (note 3) | \$ 61,938 | 28,333 |
| Investments (note 4) | 353,886 | 388,586 |
| Accrued interest receivable | <u>2,450</u> | <u>2,950</u> |
| Total assets | <u>\$ 418,274</u> | <u>419,869</u> |
| Trust Fund Balances | | |
| Held for individual Indians (notes 6 and 8) | <u>\$ 418,274</u> | <u>419,869</u> |

See accompanying notes to financial statements.

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
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Statements of Changes in Trust Fund Balances – Modified Cash Basis

Years ended September 30, 2006 and 2005

(In thousands)

| | 2006 | 2005 |
|---|-------------|-------------|
| Increases: | | |
| Receipts (note 8) | \$ 355,094 | 275,569 |
| Interest earned on invested funds | 20,582 | 18,197 |
| (Loss) gain on disposition of investments, net | (2,729) | 7,813 |
| | 372,947 | 301,579 |
| Decreases: | | |
| Disbursements to and on behalf of account holders | (374,542) | (278,407) |
| (Decrease) increase in trust fund balances, net | (1,595) | 23,172 |
| Trust fund balances, beginning of year | 419,869 | 396,697 |
| Trust fund balances, end of year (notes 6 and 8) | \$ 418,274 | 419,869 |

See accompanying notes to financial statements.

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
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OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Notes to Financial Statements

September 30, 2006 and 2005

(1) Background and Description of the Trust Funds

(a) Overview of the Trust Funds

Establishment and Management of the Trust Funds – The legislation that authorizes the Secretary of the United States Department of the Interior (Secretary) to manage the Individual Indian Monies Trust Funds (IIM Trust Funds) recognizes the unique trust relationship that exists between the Indian tribes, individual Indians, and the United States Government (U.S. Government). Agreements between the U.S. Government and the various Indian tribes, many of these in the form of treaties, recognize the sovereignty of tribes. During the course of the Nation's history and the U.S. Government's evolving policies toward individual Indians and Indian tribes, the trust relationship has retained characteristics based upon tribal sovereignty. The United States Congress has designated the Secretary as the trustee delegate with responsibility for the financial and non-financial resources held in trust on behalf of American Indian tribes, individual Indians, and other trust funds. In carrying out the management and oversight of the Indian trust assets, the Secretary has a fiduciary responsibility to ensure monies are received for the use of Indian lands and the extraction of natural resources from Indian lands, distribute such monies collected to the appropriate beneficiaries, ensure that trust accounts are properly maintained and invested, and ensure that accurate and complete reports are provided to the trust beneficiaries in accordance with applicable law.

The balances that have accumulated in the IIM Trust Funds have resulted generally from settlement of claims, land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources, receipt of judgment and tribal per capita distributions, and investment income.

The accompanying financial statements include only the financial assets held in trust by the Office of the Special Trustee for American Indians (OST) for trust beneficiaries and do not include: (i) the operating account balances of OST (e.g., Fund Balance with Treasury, Property, Plant, and Equipment) or (ii) other Indian trust assets, including but not limited to, Indian lands, buildings, or other non-financial assets managed by the United States Department of the Interior (Department).

The Reform Act – The American Indian Trust Fund Management Reform Act of 1994 (Public Law 103-412) (the Reform Act) authorized the establishment of OST which is headed by the Special Trustee for American Indians (Special Trustee) who reports to the Secretary. Under this legislation, the Special Trustee is responsible for oversight, reform, and coordination of the policies, procedures, systems, and practices used by various bureaus and offices of the Department, including but not limited to OST, the Bureau of Indian Affairs (BIA), the Minerals Management Service (MMS), and the Bureau of Land Management (BLM), in managing Indian trust assets.

Office of the Special Trustee for American Indians – Indian trust assets, including the IIM Trust Funds, are primarily managed under the delegated authority of OST and BIA. Management of Indian trust assets on behalf of the trust beneficiaries is dependent upon the processing of trust-related transactions within certain information systems of the Department, including but not limited to OST,

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BIA, MMS, and other Departmental bureaus and offices. BIA and other Departmental bureaus and offices are responsible for managing the natural resources located within the boundaries of Indian reservations and trust lands as well as the processing of data regarding the ownership and leasing of Indian lands. The allocation and distribution of receipts and disbursements by OST to trust beneficiaries is significantly dependent and reliant upon the receipt of timely and accurate information derived from records maintained by BIA, MMS, and other Departmental bureaus and offices (see note 7).

Regional Offices – OST and BIA maintain staff at regional offices located throughout the United States.

Agency and Field Offices – OST and BIA maintain staff at agency and field offices located throughout the United States, which are generally located near the tribes and individual Indians served. OST and BIA personnel located at most of the agency and field offices perform various functions related to trust fund activities.

(b) Description of the Trust Funds

Certain of the IIM Trust Funds described below are subject to legal, regulatory, budgetary, court-ordered, or other restrictions. Approximately 323,000 and 277,000 open accounts, held primarily for the benefit of individual Indian account holder beneficiaries and tribal entities, comprise the IIM Trust Funds as of September 30, 2006 and 2005, respectively. The IIM Trust Funds contain certain special deposit accounts that will ultimately be distributed to tribal and other entities.

The IIM Trust Funds are primarily funds on deposit for individual Indians with a beneficial interest in those funds. IIM account holders realize receipts primarily from settlement of claims, land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources, judgment and tribal per capita distributions, and investment income.

(c) Investment of Trust Funds

Authorizing legislation and a substantial body of case law specify how Indian trust funds should be managed and which financial instruments constitute appropriate investments for Indian trust funds. The IIM Trust Funds are pooled and invested in U.S. Government securities, including U.S. Department of the Treasury (U.S. Treasury) issues, U.S. Government agency issues, and U.S. Government-sponsored entity issues.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

OST uses the cash basis of accounting with certain modifications for the IIM Trust Funds, which is a comprehensive basis of accounting other than generally accepted accounting principles. Receipts are recorded when received with the exception of interest earned on invested funds (including discount accretion and premium amortization), and disbursements are recorded when issued. Investments are

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
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stated at amortized cost. Accrual adjustments to reflect interest earned but not received, and to record any applicable accretion of discounts and amortization of premiums over the terms of the investments, have been recorded in the accompanying financial statements. Interest income reported in the statements of changes in trust fund balances reflects interest earned, net of any premium amortization or discount accretion recognized during the fiscal year.

(b) *Cash and Cash Equivalents*

Management considers all highly liquid financial instruments with maturities of three months or less when purchased to be cash equivalents.

(c) *Investments*

Investment securities at September 30, 2006 and 2005 consist of U.S. Treasury issues, U.S. Government agency issues, and U.S. Government-sponsored entity issues. IIM Trust Funds are pooled and invested. Investment securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Premiums and discounts are amortized or accreted over the expected life of the related investment security as an adjustment to yield using the effective-interest method. Interest income is recognized when earned.

The IIM Trust Funds' investments have a concentration in U.S. Government securities, as mandated by 25 USC 162.

(d) *Receipts*

Receipts from various leasing activities, mineral royalties and sales of extracted minerals, timber and other forest products, fees and fines, and the granting of easements are generated from a variety of non-financial assets that are held in trust by the U.S. Government and managed by BIA and other Departmental bureaus and offices on behalf of individual Indians. Receipts on hand at the regional and agency offices, and /or in-transit at September 30, 2006 and 2005, if any, awaiting deposit to the U.S. Treasury, are not included in the accompanying financial statements.

Receipts also include payments from the U.S. Government for judgment awards and the settlement of claims.

(e) *Disbursements*

Payments disbursed from the IIM Trust Funds consist of accumulations of funds from various income-producing activities such as leasing, royalty receipts, mineral extraction, timber and other forest product sales, judgment awards, tribal per capita distributions, and investment income.

(f) *Use of Estimates*

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets at the date of the financial statements and the reported amounts of increases and decreases in trust fund balances during the reporting period. Actual results could differ from those estimates.

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(3) Cash and Cash Equivalents

Cash equivalents of approximately \$57 million and \$22 million at September 30, 2006 and 2005, respectively, consist of overnight investments with the U.S. Treasury.

(4) Investments

The amortized cost, gross unrealized holding gains, gross unrealized holding losses, and fair value of investment securities by major class of security at September 30 were as follows (amounts exclude investments in U.S. Treasury overnight securities discussed in note 3):

| | <u>Amortized cost</u> | <u>Gross unrealized holding gains</u> | <u>Gross unrealized holding losses</u> | <u>Fair value</u> |
|-------------------------------------|---------------------------|---|--|-------------------|
| | (in thousands) | | | |
| At September 30, 2006: | | | | |
| U.S. Treasury and agency securities | \$ 184,227 | 647 | (2,686) | 182,188 |
| Mortgage-backed securities | 169,659 | 189 | (2,474) | 167,374 |
| | <u>\$ 353,886</u> | <u>836</u> | <u>(5,160)</u> | <u>349,562</u> |
| At September 30, 2005: | | | | |
| U.S. Treasury and agency securities | \$ 279,765 | 2,618 | (2,449) | 279,934 |
| Mortgage-backed securities | 108,821 | 68 | (1,634) | 107,255 |
| | <u>\$ 388,586</u> | <u>2,686</u> | <u>(4,083)</u> | <u>387,189</u> |

Certain of the September 30, 2005 amounts above have been reclassified between security types to conform to the September 30, 2006 classifications.

Maturities of investment securities were as follows at September 30, 2006:

| | <u>Amortized cost</u> | <u>Fair value</u> |
|--|-----------------------|-------------------|
| | (in thousands) | |
| Due in one year or less | \$ 29,998 | 29,848 |
| Due after one year through five years | 69,293 | 66,653 |
| Due after five years through ten years | 28,708 | 28,395 |
| Due after ten years | 225,887 | 224,666 |
| | <u>\$ 353,886</u> | <u>349,562</u> |

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
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(5) Contingencies

Certain parties for whom OST holds assets in trust have filed a class action lawsuit for an accounting of the individuals' trust funds which may or may not lead to claims against the U.S. Government. The lawsuit alleges that the Department and U.S. Treasury have breached their trust obligations with respect to management of funds in the IIM accounts. Neither OST nor the Office of the Solicitor for the Department can presently determine the outcome of these actions nor the total amount, responsibility, and funding source of the potential liability. Any settlement resulting from an adverse outcome of the contingencies described above is not expected to be satisfied with trust fund balances. No amounts have been recorded in the accompanying IIM Trust Funds' financial statements for potential claims from the U.S. Government.

(6) Trust Fund Balances

Trust fund balances are the aggregation of financial assets held in trust and primarily represent the amounts owed to beneficiaries as of September 30, 2006 and 2005 for which OST has a fiduciary responsibility.

The net total of the balances reflected in the IIM account holders' subsidiary detail of accounts is less than the trust fund balances reported in the accompanying financial statements as of September 30, 2006 and 2005 due to certain cumulative differences.

Historically, the aggregate sum of positive account balances in the IIM subsidiary detail of account holders' balances has exceeded the trust fund balances reported in the accompanying financial statements. As of September 30, 2006 and 2005, this difference was approximately \$6 million. As of September 30, 2006 and 2005, there are certain accounts with negative balances in the IIM account holders' subsidiary detail aggregating approximately \$44 million (of which approximately \$164,000 and \$192,000 is attributed to individual Indian accounts as of September 30, 2006 and 2005, respectively).

The subsidiary detail of IIM account balances contains approximately 22,000 and 20,000 special deposit accounts with balances totaling approximately \$36 million and \$40 million as of September 30, 2006 and 2005, respectively. The majority of the special deposit account monies held in the IIM Trust Funds relates to historical balances and has not been distributed because the ultimate disposition of the funds has not been determined. Since the ultimate disposition is unknown at September 30, 2006, the portion attributable to the IIM Trust Funds is unknown.

The subsidiary detail of IIM account balances contains certain oil and gas holding accounts with balances totaling approximately \$7.4 million and \$7.9 million as of September 30, 2006 and 2005, respectively, which have not been distributed to beneficiaries. Upon receipt of the allocation and accounting data, provided by MMS and BIA, the monies will be distributed to IIM account holders' accounts (see note 7).

A portion of trust fund balances represents estimated payments on production-type leases for which certain individual Indians and tribes hold an interest. When certain adjustments to production are identified, estimated payments in excess of production are returned to the depositor or adjusted for in future payments.

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(7) Related-Party Transactions with Other Government Organizations

(a) U.S. Department of the Interior Bureau of Indian Affairs

BIA is responsible for the collection of certain monies resulting from the management and use of Indian trust lands and other trust resources. Upon receipt, OST records the deposit of trust funds to trust accounts based on the information received from BIA.

(b) U.S. Department of the Interior Minerals Management Service

For certain trust leases, MMS is responsible for the collection of royalty payments on behalf of Indian tribes and individual Indians holding mineral rights. MMS deposits the royalty payments with the U.S. Treasury and electronically transfers to OST the related accounting information, generally the next business day. For tribally/individually co-owned leases, and individually owned leases, the allocation and accounting data to distribute the monies to the proper IIM account is forwarded to OST via electronic interface through the Royalty Distribution Reporting System that is maintained by BIA. Pursuant to established procedure and appropriate authorization, the data is recorded by OST. MMS and BLM both perform verification and other monitoring procedures of mineral assets. Oil and gas companies sometimes forward payments to MMS based on estimated mineral production in order to comply with the Federal Oil and Gas Royalty Management Act of 1982 that requires timely distribution of royalties. These estimated payments may be disbursed by OST to the beneficiaries. Typically, the oil and gas companies adjust future payments for excess or shortfall amounts, if any, based on actual production.

(c) Other

The U.S. Treasury holds cash and certain investments and in certain instances disburses for OST.

The Department's Office of the Solicitor serves as legal counsel for OST.

(8) Transfers of Trust Funds

OST, pursuant to information provided by BIA, utilizes special deposit accounts (see note 6) maintained within the IIM Trust Funds for both tribal and IIM beneficiaries as suspense accounts, whereby funds are temporarily posted when allocation information is not provided when the funds are received. Following receipt of allocation information from BIA, the funds are transferred from the special deposit accounts to the designated tribal and/or IIM account(s). In addition, certain per capita disbursements authorized by tribes result in transfers from the Tribal and Other Trust Funds to the IIM Trust Funds while certain oil and gas distributions may result in transfers to/from the IIM Trust Funds from/to the Tribal and Other Trust Funds. Net transfers of trust funds to the IIM Trust Funds from the Tribal and Other Trust Funds totaled approximately \$43.3 million and \$34.1 million during the years ended September 30, 2006 and 2005, respectively. These transfers are reflected as receipts in the accompanying statements of changes in trust fund balances.



**TRIBAL AND OTHER TRUST FUNDS AND
INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Independent Auditors' Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters

September 30, 2006



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Albuquerque, NM 87190

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

The Special Trustee for American Indians
U.S. Department of the Interior Office of the Special Trustee for American Indians

U.S. Department of the Interior Office of Inspector General:

We have audited the accompanying statements of assets and trust fund balances – cash basis of the Tribal and Other Trust Funds as of September 30, 2006 and 2005, and the related statements of changes in trust fund balances – cash basis for the years then ended, and the statements of assets and trust fund balances – modified cash basis of the Individual Indian Monies Trust Funds as of September 30, 2006 and 2005, and the related statements of changes in trust fund balances – modified cash basis for the years then ended (collectively referred to as the Trust Funds Financial Statements) managed by the U.S. Department of the Interior Office of the Special Trustee for American Indians (OST) and have issued our reports thereon dated November 9, 2006. The objective of our audits was to express opinions on the fair presentation of the Trust Funds Financial Statements. In connection with our fiscal year 2006 audit, we also considered OST's internal control over financial reporting and tested OST's compliance with certain provisions of applicable laws, regulations, and contracts that could have a direct and material effect on the Trust Funds Financial Statements.

Summary

Our audit reports on the Trust Funds Financial Statements were qualified because it was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the fairness of trust fund balances in the Trust Funds Financial Statements as of September 30, 2006 and 2005 due to certain parties for whom OST holds assets in trust having filed a class action lawsuit for an accounting of the individuals' trust funds which may or may not lead to claims against the United States Government, and other parties for whom OST holds assets in trust disagreeing with the balances recorded by OST and/or having requested an accounting of their trust funds, and certain of these parties have filed, or are expected to file, claims against the United States Government and due to inadequacies in certain Department of the Interior trust-related systems and processes, which provide required trust financial information to OST. Trust fund balances enter into the determination of financial position and changes in trust fund balances.

Our reports also state that the Trust Funds Financial Statements are prepared in accordance with a basis of accounting which is a comprehensive basis of accounting other than generally accepted accounting principles as described in notes 2 to the Trust Funds Financial Statements.

Our consideration of internal control over financial reporting resulted in the following condition being identified as a reportable condition:

Reliance on processing of trust transactions at the Bureau of Indian Affairs and unresolved financial reporting matters from prior periods.

We consider this reportable condition to be a material weakness.

The results of our tests of compliance with certain provisions of laws, regulations, and contracts disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards*, issued by the Comptroller General of the United States.

The following sections present an overview of the Trust Funds Financial Statements, and discuss our consideration of OST's internal control over financial reporting, our tests of OST's compliance with certain provisions of applicable laws, regulations, and contracts, and management's and our responsibilities.

Overview – Trust Funds Financial Statements

The United States Congress has designated the Secretary of the United States Department of the Interior (the Secretary) as the trustee delegate with responsibility for the financial and non-financial resources held in trust on behalf of American Indian tribes, individual Indians, and other trust funds. In carrying out the management and oversight of the Indian trust assets, the Secretary has a fiduciary responsibility to ensure monies are received for the use of Indian lands and the extraction of natural resources from Indian lands, distribute such monies collected to the appropriate beneficiaries, ensure that trust accounts are properly maintained and invested, and ensure that accurate and complete reports are provided to the trust beneficiaries in accordance with applicable law.

The American Indian Trust Fund Management Reform Act of 1994 (Public Law 103-412) (the Reform Act) authorized the establishment of OST which is headed by the Special Trustee for American Indians (Special Trustee) who reports to the Secretary. Under this legislation, the Special Trustee is responsible for oversight, reform, and coordination of the policies, procedures, systems, and practices used by various bureaus and offices of the Department of the Interior (Department), including but not limited to OST, the Bureau of Indian Affairs (BIA), the Minerals Management Service (MMS), and the Bureau of Land Management (BLM), in managing Indian trust assets.

Internal Control Over Financial Reporting

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect OST's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal control, misstatements due to error or fraud may nevertheless occur and not be detected.

In our fiscal year 2006 audits, we noted certain matters, described below, involving internal control over financial reporting and its operation that we consider to be a reportable condition. We believe that the reportable condition is a material weakness.

Reliance on Processing of Trust Transactions at the Bureau of Indian Affairs and Unresolved Financial Reporting Matters from Prior Periods

Condition

Indian trust assets, including the trust funds, are primarily managed under the delegated authority of OST and BIA. Management of Indian trust assets on behalf of the trust beneficiaries is dependent upon the processing of trust-related transactions within certain information systems of the Department, including but not limited to OST, BIA, MMS, and other Departmental bureaus and offices. BIA and other Departmental bureaus and offices are responsible for managing the natural resources located within the boundaries of Indian reservations and trust lands, as well as the processing of data regarding the ownership and leasing of Indian lands. The allocation and distribution of receipts and certain disbursements by OST to trust beneficiaries is significantly dependent and reliant upon the receipt of timely and accurate information derived from records maintained by BIA, MMS, and other Departmental bureaus and offices.

The financial information systems and internal control procedures used in the processing of Indian trust transactions have suffered historically from a variety of system and procedural internal control weaknesses. In addition, current management is burdened with the ongoing impact of decades of accumulated discrepancies in the accounting records. Furthermore, certain Indian trust beneficiaries do not agree with the Indian trust balances and/or have requested an accounting of the Indian trust funds. The Department has invested a significant amount of resources identifying historical records and preparing an accounting of the Indian trust fund balances and will continue with this historical accounting effort.

The regional and agency offices of BIA perform a critical role in the initial input and subsequent changes to Indian trust financial information. The independent auditors' report on internal control over financial reporting and compliance and other matters for the year ended September 30, 2006 at BIA noted weaknesses in the following areas:

- a. Trust Systems – BIA had not consistently implemented automated systems for tracking and processing activities of the Indian trust assets. Agency offices use “off-the-shelf” software, internally developed software, in-house databases, and manual processes to manage ownership records, track lease activity, account for receivables/revenue, and determine distribution amounts. BIA has developed an automated system for certain activities and completed the first phase of the roll-out in September 2006. The second phase of the roll-out is expected to be completed in all agency offices as of September 30, 2007. This situation increases the risk that transactions are recorded inaccurately and untimely.
- b. Accounts Receivable – BIA had not fully developed and communicated standardized policies and procedures for establishing, tracking, and pursuing accounts receivable for the Indian trust funds. This resulted in inconsistent processes and increases the risk that amounts due to Indian trust funds are not identified and ultimately collected.
- c. Probate Backlog – BIA did not consistently enter probate orders for land title into the trust management systems timely. Although BIA made progress in reducing the backlog, BIA indicated that it had probate orders that had not been prepared, adjudicated, recorded, and/or encoded. BIA expects to have the backlog resolved by September 2009. This increases the potential for untimely distributions of income to the account holders of the Indian trust funds.

- d. Supervised and Restricted Accounts – BIA did not consistently perform reviews over active supervised accounts, nor did they maintain documentation for supervised accounts, including social service assessment and evaluation forms, disbursement documentation, annual review documentation, court orders, and notification of restriction letters. Additionally, BIA did not consistently perform reviews over active supervised accounts for contracted or compacted tribes. BIA also did not have a standardized policy on when annual reviews of active supervised accounts should be conducted in that they relied on each region to develop its own policy. Finally, although each of the regions that we visited had compiled a listing of active supervised accounts, the regions expended significant efforts generating the listing. BIA has since identified a report from the Trust Fund Accounting System (TFAS) which lists all active supervised accounts, and needs to work with OST to validate the completeness of this report and, once validated, ensure its timely distribution to the appropriate agency offices.

The presence of these internal control weaknesses directly impacts OST's ability to process trust transactions on behalf of trust beneficiaries and to provide accurate information to account holders due to the interrelationship between BIA and OST.

In addition, as of September 30, 2006, several significant financial reporting differences from prior periods have not been resolved. These items have a material effect on the Trust Funds Financial Statements as of September 30, 2006 and 2005, and for the years then ended. These differences from prior periods, which have not been resolved, include the following:

Lack of Reliable IIM Balance – IIM

The TFAS control account for IIM account holders represents the aggregate net balance of trust funds held on behalf of IIM account holders as reflected in the detailed subsidiary ledger of IIM accounts (subsidiary ledger) also in TFAS. The control account balance has historically not agreed to the sum of the balances from the subsidiary ledger and it cannot be determined which balance, if either, is correct. Consequently, the balance of funds invested for IIM account holders may not be correct. The amount invested for IIM is based on the IIM control account balance in TFAS. As of September 30, 2006 and 2005, the aggregate sum of all positive balances included in the subsidiary ledger exceeded the control account by approximately \$6,000,000. Accordingly, IIM account holders with positive balances may be penalized by lower interest earnings. In addition, as of September 30, 2006 and 2005, the subsidiary ledger contained negative account balances totaling approximately \$43,800,000 (of which approximately \$164,000 and \$192,000 was attributed to individual Indian accounts as of September 30, 2006 and 2005, respectively).

Trust Fund Balances – Tribal

An historical "undistributed interest" house account of approximately \$1,800,000 existed at September 30, 1995. The balances as of September 30, 2006 and 2005 were approximately \$2,009,000 and \$1,817,000, respectively. Interest earned on these funds was allocated to the house account. During fiscal year 2005, OST commissioned a report to assist in determining the recipients of these funds. It is our understanding that OST has distributed this amount subsequent to September 30, 2006.

Cash – Tribal

As of September 30, 2006 and 2005, there were eleven and twelve accounts in TFAS with negative balances totaling approximately \$721,000 and \$724,000, respectively, carried forward from the previous trust funds accounting system prior to the conversion to TFAS.

Special Deposit Accounts – Tribal and IIM

As of September 30, 2006 and 2005, there were approximately 22,000 and 20,000 special deposit accounts reflected in the subsidiary ledger in TFAS with balances totaling approximately \$36 million and \$40 million, respectively. In accordance with Title 25 of the Code of Federal Regulations and as directed by BIA, OST records receipts into special deposit accounts within the subsidiary ledger when the recipient trust fund account is unknown at the time of receipt. When BIA identifies the trust fund account(s), OST transfers the amount from the special deposit account(s) to the designated trust fund account(s) in accordance with BIA instructions. A significant number of special deposit accounts have remained inactive for the past several years and new accounts continued to be established during the years ended September 30, 2006 and 2005. During fiscal years 2002 and 2001, management of OST, together with BIA and a contractor, developed and put in place a formal plan to address special deposit accounts. Beginning in fiscal year 2003, the Office of Historical Trust Accounting began working with OST and BIA to distribute funds in special deposit accounts that were opened on or before December 31, 2002. Special deposit account activity after that date will be addressed by BIA, with instructions for distributions being provided to OST. At September 30, 2006, a significant number of special deposit accounts continue to require resolution.

Trust Fund Balances – IIM

An historical “undistributed interest” house account of approximately \$1,205,000 existed at September 30, 1990. The balances as of September 30, 2006 and 2005 were approximately \$2,200,000 and \$2,110,000, respectively. Interest earned on these funds is recorded in the house account. The allocation of these funds has not been determined.

During fiscal years 2002 and 2004, approximately \$922,000 and \$375,000, respectively, was transferred from certain special deposit accounts to “undistributed interest” house accounts in connection with the review of certain special deposit accounts performed by OST, together with BIA and a contractor. Interest earned on these funds was recorded in current IIM accounts through September 30, 2005. Beginning October 1, 2005, interest earned on these funds was recorded in the respective undistributed interest accounts. The balances as of September 30, 2006 were approximately \$962,000 and \$390,000, respectively. The allocation of these funds has not been determined.

Recommendation

We recommend that management of OST:

- 1 Continue to work collaboratively with BIA to correct the weaknesses identified above such that OST may fulfill its fiduciary responsibility to the trust fund beneficiaries; and
- 2 Continue to work to resolve the unresolved financial reporting differences as soon as practicable. In situations where actions or inputs from Department officials are needed to resolve a matter, we recommend management of OST continue to work with appropriate Department officials such that all matters are resolved as soon as practical.

OST Management’s Response to Unresolved Financial Reporting Matters from Prior Periods

Management does not concur that the findings are a material weakness individually or collectively. Based on OMB 06-03, [Material Weakness]es are defined as: “reportable conditions in which the design or operation of the internal control does not reduce to a relatively low level the risk that errors, fraud or noncompliance in amounts that would be material in relation to the Basic Statements or Required Supplementary Stewardship Information being audited, or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by

employees in the normal course of performing their assigned functions.” The historical conditions that resulted in the findings have been corrected through the implementation of internal controls that mitigate the risk of recurrence. These controls are in place and operating effectively, therefore, there is no impact or no material impact (\$6 million) on the current financial internal control environment. We believe that the Trust Funds Accounting System (TFAS) is reliable and monies are being accounted for accurately and timely. Additionally, the \$2,009,000 Trust Funds Balances reported, was resolved and distributed in October 2006.

BIA Management’s Response to Processing of Trust Transactions at BIA

Management does not concur. Management believes that a variety of corrective actions have been taken that significantly improved internal control activities and systems for Indian Trust Funds. Based on the results of our internal controls test work, management concludes that the controls in place are operating effectively, and that these controls ensure there is no negative material impact on the current financial internal control environment.

We believe that there is a high degree of accuracy in the Trust Fund account balances, the Trust Asset Management System is reliable, and the data contained therein is accurate and timely.

Auditors’ Response to Managements’ Response

As summarized in the condition section above, management had not resolved significant financial reporting differences from prior periods and weaknesses in BIA trust-related systems and processes continue to exist at September 30, 2006. Therefore, we continue to believe that the weaknesses identified constitute a material weakness.

Exhibit I presents the status of prior year reportable conditions. We also noted certain additional matters that we reported to management of OST in a separate letter dated November 9, 2006.

Compliance and Other Matters

The results of our tests of compliance described in the Responsibilities section of this report disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards*.

We noted other matters involving compliance with laws, regulations, and contracts that, under *Government Auditing Standards*, were not required to be included in this report, which we have reported to OST management in a separate letter dated November 9, 2006.

Responsibilities

Management’s Responsibilities

The American Indian Trust Fund Management Reform Act of 1994 requires that the Secretary shall cause to be conducted an annual audit on a fiscal year basis of all funds held in trust by the U.S. Government for the benefit of an Indian tribe or an individual Indian, which are deposited or invested pursuant to the Act of June 24, 1938 (25 U.S.C. 162a).

Management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with the basis of accounting described in notes 2 of the Trust Funds Financial Statements;
- Establishing and maintaining internal control; and

- Complying with laws, regulations, and contracts applicable to OST.

In fulfilling this responsibility, management is required to make estimates and judgments to assess the expected benefits and related costs of internal control policies.

Auditors' Responsibilities

Our responsibility is to express opinions on the fiscal year 2006 and 2005 Trust Funds Financial Statements based on our audits. Except as discussed in the fourth paragraph of our auditors' reports, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing opinions on the effectiveness of internal control over financial reporting of the Tribal and Other Trust Funds and IIM Trust Funds managed by OST. Accordingly, we express no such opinions.

An audit also includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall financial statement presentation.

We believe that our audits provide a reasonable basis for our opinions.

In planning and performing our fiscal year 2006 audits, we considered OST's internal control over financial reporting by obtaining an understanding of OST's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audits was not to provide an opinion on OST's internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether the fiscal year 2006 Trust Funds Financial Statements are free of material misstatement, we performed tests of OST's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to OST. However, providing an opinion on compliance with laws, regulations, and contracts was not an objective of our audits, and accordingly, we do not express such an opinion.

Restricted Use

This report is intended solely for the information and use of the Department's management, the U.S. Department of the Interior Office of Inspector General, Office of Management and Budget, the U.S. Government Accountability Office, and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 9, 2006

**TRIBAL AND OTHER TRUST FUNDS AND
INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Status of Reportable Conditions, Reported as of September 30, 2005

September 30, 2006

| <u>Reference</u> | <u>Condition</u> | <u>Current-Year Status</u> |
|------------------|--|--|
| OST-2005-A* | Reliance on Processing of Trust Transactions at the Bureau of Indian Affairs | Repeated, with certain modifications in current-year report – see current-year reportable condition, considered a material weakness. |
| OST-2005-B* | Financial Reporting – Unresolved Matters from Current and Prior Periods | Repeated, with certain modifications in current-year report – see current-year reportable condition, considered a material weakness. |

* The nature of these issues has been reported in prior years by KPMG and the prior auditor. During the current year these items were combined into one reportable condition, considered a material weakness.

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